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TAGS: EFIN ECON PREL KU
SUBJECT: COMMERCE U/S LAVIN AND KUWAIT INVESTMENT AUTHORITY
DISCUSS INVESTMENT AND TAXES

¶1. (SBU) Summary: On March 14, Undersecretary of Commerce for International Trade Ambassador Frank Lavin met with Kuwait Investment Authority (KIA) Managing Director Bader Al-Saad to discuss recent developments in trade and investment in U.S., Kuwaiti, regional and international markets. Al-Saad noted that despite recent market instability, KIA sees no change in Asian markets. U/S Lavin briefed KIA on the recent launch of the Department of Commerce-led "Invest in America Initiative" which will not only promote inward investment but will also include outreach to the U.S. public and private sector to decrease deterrents to foreign direct investment in the U.S. Al-Saad noted that KIA was forced to liquidate USD 4-5 billion of U.S. real estate holdings due to changes in the U.S. tax law in 1998. He also acknowledged Kuwait needs foreign investor-friendly changes to its own tax law in order to keep up with its regional neighbors. The meeting was also attended by the KIA Managing Director's Office Manager Ahmed Bastaki, KIA Acting Head of the General Reserve Fund Khalid Khasom, and Emboffs. End summary.

China is Overheated, but Market has Overreacted

¶2. (SBU) U/S Lavin met with KIA Managing Director Bader Al-Saad on March 14 during a two-day visit to Kuwait as part of a multi-country regional tour. Al-Saad briefly updated U/S Lavin on KIA's activities and noted that recent market instability could not have come at a more inopportune time as KIA,s fiscal year ends on March 31st. However, he acknowledged that KIA sees no fundamental change in Asian markets despite recent woes. China is overheated with overvaluation and saturation, he said, but the overall market response has been exaggerated.

"Invest in America Initiative": Trade Promotion, Advocacy, and Action

¶3. (SBU) Noting that historically the U.S. has had no formal mechanism to facilitate access for potential investors, U/S Lavin announced the advent of the Department of Commerce-led "Invest in America Initiative." He explained that the U.S. had CFIUS for transactions with national security significance but no procedures for general inward investment. The domestic debate surrounding the Dubai Ports deal brought a number of problems to light, including the absence of a single lead agency. Investment decisions, U/S Lavin affirmed, should be made on an investment basis and not on politics. "We can't tell friends simply that we like you and we want your business, and we hope you do not have problems. We must do more," he said. Al-Saad asked what precipitated this decision. Lavin said the U.S. needs to be proactive.

This initiative, which includes outreach to both the U.S. public and private sector, will encourage inward investment. When asked if there has been a change in the flow of investments into the U.S., he noted that the U.S. economy did well in 2006 but it is difficult to measure opportunity costs. "A good manager would say that it should have been better," he explained. Kuwait like the U.S. is blessed by tremendous resources but neither country can afford to become complacent. In this era of globalization, he concluded, mistakes will encourage investors to simply go elsewhere.

U.S. Tax Laws Forced KIA to Liquidate
USD 4-5 Billion in Real Estate Holdings

¶4. (SBU) Al-Saad clarified that KIA is unlikely to have problems like those associated with the Dubai Port deal because most of KIA's transactions are handled by fund managers in the U.S. and Europe. However, he added that KIA was significantly impacted by 1998 changes to the U.S tax law that forced it to liquidate USD 4-5 billion in U.S. real estate holdings. KIA raised its concerns with USG officials in the U.S. and Kuwait and consulted with tax attorneys to no avail. Ahmed Al-Bastaki noted that existing tax exemptions for pension funds should be extended to KIA since it essentially operates as a pension fund for the Government of Kuwait. U/S Lavin encouraged KIA to seek like-minded entities in Japan, Britain, and other countries with significant U.S. investments to raise this issue on a multilateral basis. U/S Lavin offered to assist KIA in its efforts and noted that KIA's biggest ally could be the U.S. real estate industry.

¶5. (SBU) Embassy Comment: KIA has long complained in

particular about real estate taxes in the U.S., which it argues levy a heavy burden on KIA's U.S. investments, with capital gains running as high as thirty-five percent. KIA is also disgruntled with the branch profit tax, a thirty-percent tax levied on Kuwaiti subsidiaries operating in the U.S. The U.S. is the most important destination for KIA's investments, and a significant portion of KIA's assets under management are either in the U.S. or in USD-denominated assets. KIA's investments in the U.S. are in most asset classes but are predominantly in marketable securities (equities and fixed income). Investments in the U.S. through KIA's office in Kuwait are managed through various External Fund Managers (EFM) who either co-mingle or have unique portfolios to manage KIA's American investments. KIA's office in London, the Kuwait Investment Office, is an active investor which trades directly in U.S. securities. Nearly all EFMs of KIA are major U.S. financial institutions as well as leading U.S. asset managers. KIA is active in alternative investments including private equities, where KIA is participating in some of the private equity funds. KIA's real estate holdings are through BreadStreet, a one-hundred-percent owned entity of KIA. KIA normally allocates its assets based on world GDP contributions, but for the U.S., KIA officials tell us KIA is significantly overweighted in its asset allocation due to attractive potential investment opportunities as well as the depth and stability of the U.S. markets. End Comment.

Why Didn't Halliburton Move to Kuwait?
Kuwait Corporate Taxes Impede Economic Growth

¶6. (SBU) Econoff noted that American and other foreign investors face similar challenges in Kuwait due to disproportionately high taxes. Al-Saad stated that the problem of corporate taxes goes back to 1955, when a revenue-sharing measure with British oil companies went into effect. It was called a tax, and the GOK has yet to update it. Bastaki asked U/S Lavin about the reason for Halliburton's recent announcement to move to Dubai, wondering if the move was prompted by a desire to avoid U.S. taxes. U/S Lavin

noted that is was probably a combination of moving to a tax-free zone, and gaining greater proximity and access to regional markets. Domestically U/S Lavin noted that people are also wondering what this move will mean for jobs in the U.S. However, U/S Lavin said Kuwait should really be asking "if Halliburton's relocation to Kuwait was even an option and, if not, how can Kuwait get a company like Halliburton in the future?" Al-Saad acknowledged that while there is a 10-year tax exemption for some direct investment, Kuwait needs to change the corporate tax law. Pointing to Dubai, Al-Saad concluded that Kuwait needs changes to keep up.

Americans Are Too Expensive

¶7. (SBU) Bastaki also noted that U.S. income tax requirements are pricing American laborers out of overseas markets. In Kuwait, firms hire Canadians, British, and other native English-speakers, he explained, because Americans are just too expensive to be competitive.

¶8. (SBU) This cable has been cleared by Commerce U/S Lavin.

LeBaron